betashares

Brave New World

Investment Outlook

2025

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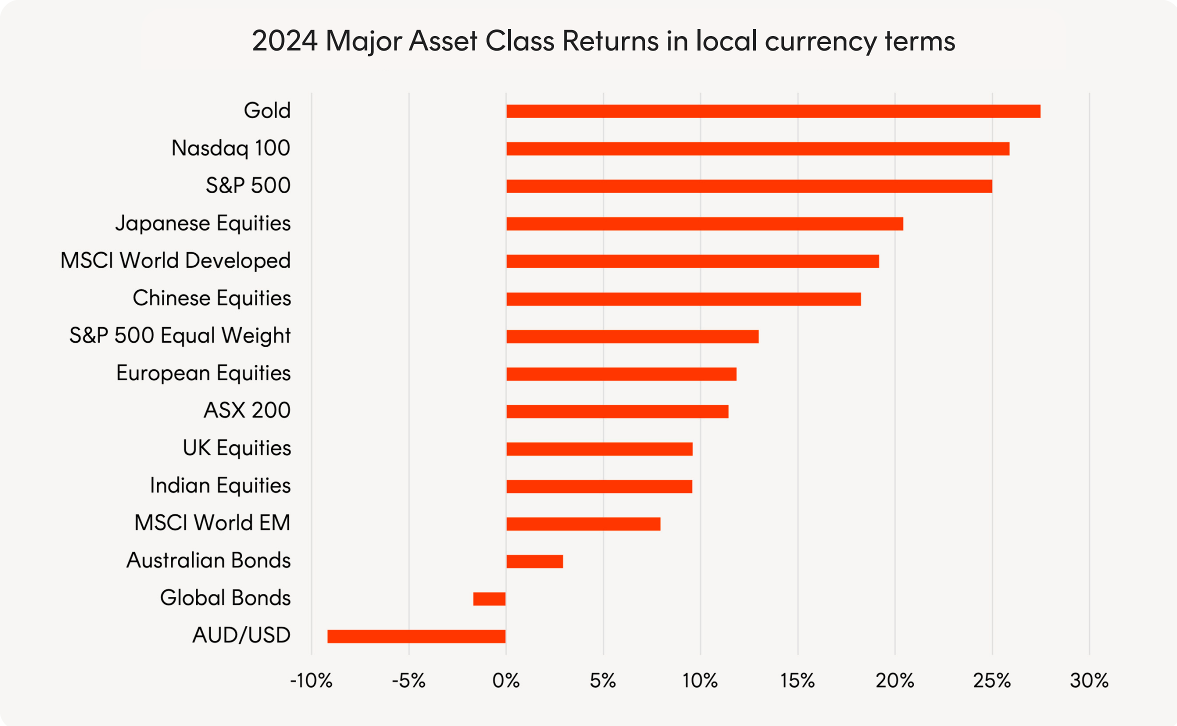
Introduction

For many investors 2024 was a great year, particularly those who held equities.

The US S&P500 and the S&P/ASX 200 indices both performed strongly, with total returns of 25% and 11.4%, respectively. Much of these gains were driven by continued momentum in a narrow band of winners, the 'Mag 7' in the US and the banks in Australia. Credit and the USD also did well, the latter of which provided even greater gains for Australian investors holding unhedged global assets. Gold beat even US equities, while other commodities were soft and government bond returns were muted. Bitcoin was off the charts.



Source: Bloomberg. Returns from 31 December 2023 to 31 December 2024 in local currencies. Gold = XAU BGN Currency Index, Chinese equities = CSI 300 Index, UK Equities = FTSE 100, Japanese Equities = Topix Index, Indian Equities = Sensex Index, European Equities = Eurostoxx Index, Australian Bonds = BACM0 Index, Global Bonds = LEGATRUU Index AUD/USD = Australian and US Dollar exchange rate. You cannot invest directly in an index. Past performance is not an indicator of future performance.

Growth assets responded positively as a 'Goldilocks' scenario, of falling inflation and resilient economic growth, played out, particularly in the US.

While diversified portfolios did well in 2024, that was a result of the strong contribution of equities. Bonds provided little in terms of returns or diversification.

In 2025 the starting point is quite different: equity markets are more concentrated, at a headline level indices look more expensive and government bond yields are higher. Nevertheless, an improved economic outlook bodes well for equities if you know where to look. Our base case for 2025 is that solid earnings growth can drive equity markets higher at a headline level. However, we expect elevated equity volatility, and high quality bonds now offer attractive income over cash for those seeking to diversify risk.

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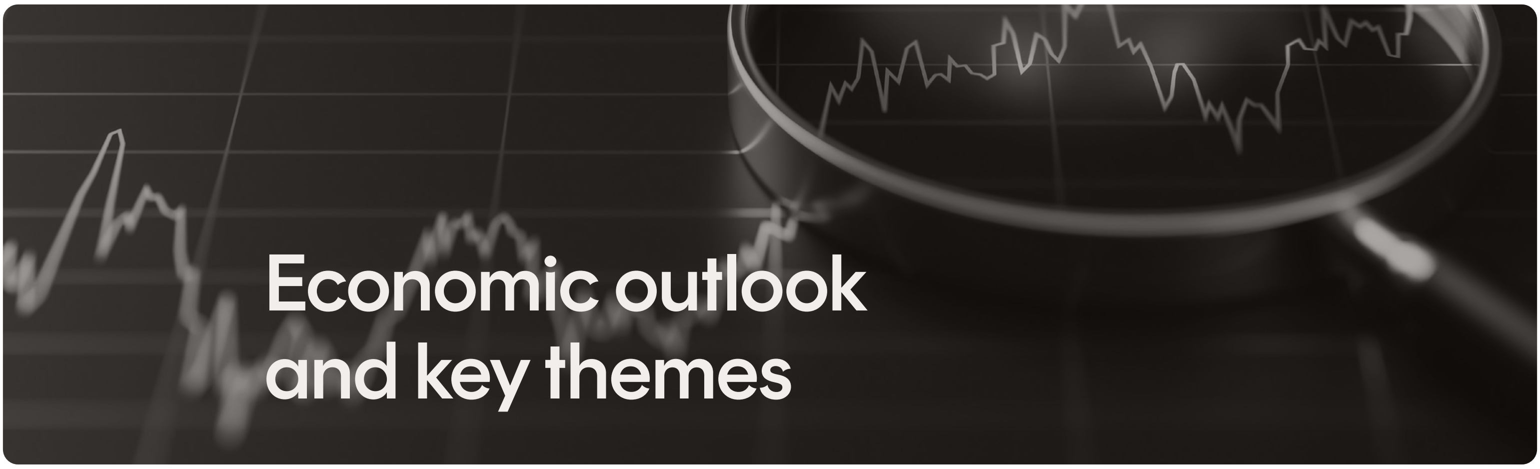
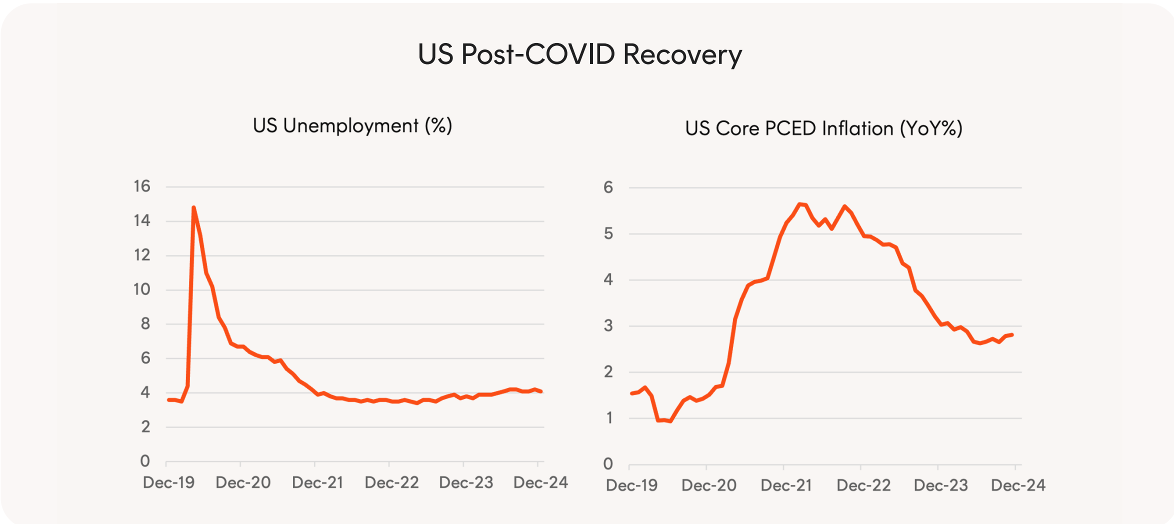
In this outlook piece we discuss the macro landscape and evaluate the investment opportunities and risks faced by Australian investors as we enter a year likely to be defined by heightened policy uncertainty.



Economic outlook and key themes

The goldilocks economic fairytale should continue

Despite bouts of uncertainty, the key global economic development in 2024 was the persistence of relatively resilient global economic growth and declining inflation – led once again by the world's leading economy, the United States. US unemployment rose only modestly over the year, from 3.8% to 4.1%. Annual underlying US inflation fell from 3.0% to 2.8%.



Source: LSEG Datastream / Betashares

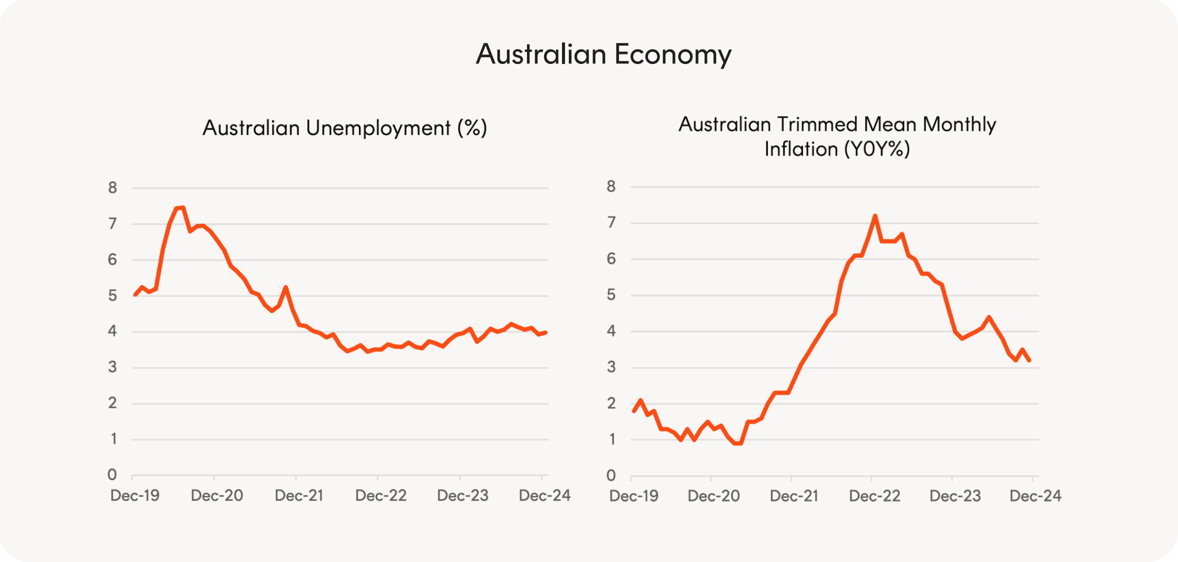
Although the decline in US underlying inflation began to stall by year-end, the disinflationary process was sufficiently encouraging over the first half of the year for the US Federal Reserve to begin reducing policy restrictiveness, with the Fed funds target range falling 1% from 5.25%-5.5% to 4.25%-4.5%.

Outside of the United States, economic performance remained less impressive. While Japan's economy benefited from higher wage growth and consumer spending, weak population growth kept overall economic growth still modest. Rising inflation nonetheless saw the Bank of Japan begin the process of raising official rates from near-zero levels – which caused a brief bout of global market volatility in August.

European economic growth remained weak, reflecting high energy costs and weak growth in both productivity and the labour force.

Falling European inflation, however, also allowed the European Central Bank to start cutting interest rates from restrictive levels. In China, growth remained modest reflecting a property overhang, weak consumer spending and limited fiscal and monetary stimulus.

In Australia, underlying inflation has also fallen, although remains above the Reserve Bank's 2 to 3% target band. While economic growth has been subdued, due to persistent weak consumer spending, employment growth remained solid and unemployment low thanks to a booming "care" sector. The combination of weak economic growth yet solid employment gains has been reflected in weak productivity growth and still firm growth in unit labour costs. Still firm inflation and a solid labour market meant the RBA left interest rates on hold last year despite the ongoing pressures on consumer spending.



Source: LSEG Datastream / Betashares

With US economic growth on track to remain relatively resilient, the key global macroeconomic question in 2025 is whether the disinflationary process can continue. Although inflation has fallen, it remains above central bank target levels in many countries, and market expectations for further official interest rate cuts could be threatened if the decline in inflation stalls – as has been evident in the United States over the final months of 2024.

Although there are risks – in particular with regard to the second Trump US Presidency as discussed below – **our base case view is that global inflation, especially in the United States, should continue to ease.**

In the US, for example, an easing in labour market tightness should continue to see wage growth slow, which should bear down on still sticky service sector inflation. US housing inflation should also continue to ease given a slowing in rents and housing construction costs. Barring any upsurge in supply-chain disruption, goods inflation should also remain benign.

In 2025 we expect the RBA finally join the rate cutting party, with three 0.25% rate cuts, in line with market expectations.

G7 + Australasia Policy Rates

Country	Sep-24	Dec-24	Dec-25 implied rate	Expected rate change over 2025
United States	4.875%	4.375%	3.944%	-0.431%
Euro Zone	3.500%	3.000%	1.842%	-1.158%
Japan	0.250%	0.250%	0.742%	+0.492%
United Kingdom	5.000%	4.750%	4.157%	-0.593%
Canada	4.250%	3.250%	2.583%	-0.667%
Australia	4.350%	4.350%	3.541%	-0.809%
New Zealand	5.250%	4.250%	2.997%	-1.253%

Source: Bloomberg, as at 31-Dec-2024; Implied forward rates from futures or overnight indexed swaps.

Policy uncertainty and deglobalisation

One notable political development in 2024 was that many incumbent national governments that presided over the post-COVID surge in inflation, fairly or not, were bundled out of office. The political upheaval was no more apparent than in the United States, with Donald Trump returning to the US Presidency for the second time. Peak globalisation and multilateralism appear to be behind us, and Trump is intent on breaking down the status quo.

Trump has proposed a range of policies, from cuts in illegal immigration, regulation, taxation and public spending to – most controversial of all – higher tariffs on imported products which has the potential to cause a new global trade war. The economic and market impact of these policies in 2025 will likely depend on which policies he prioritises first and the vigour with which he pursues them.

While deregulation and public spending cuts could be warmly greeted by markets, unfunded tax cuts alone and a trade war pose risks, to the extent they could push up inflation and interest rates. However, tax cuts require Congressional approval and could require some tweaks to gain the support of Republican fiscal hawks. In terms of tariffs, we expect Trump's early focus to be China, but don't be surprised to see bilateral trade negotiations with other countries in place of a universal 10% import duty. At the time of writing, Trump's team are reported to be favouring a gradual approach to implementing tariffs.

On immigration, we expect Trump will focus on stopping the flow of new immigrants and to make lots of noise about deportations of immigrants already living in the US to appease his political base. But we do not believe he will meet his target of deporting one million immigrants a year [1]. Implementing mass deportations on this scale would face various challenges. Not to mention the risks to inflation and growth, as a result of removing one million people a year from an economy with an unemployed population of only 7 million.

On balance, however, our assessment is that Trump's bark will likely be worse than his bite. No modern-day president has had such a fixation with the stock market and, if a trade war or higher interest rates cause a sell off, then Trump will likely rein himself in. The fact he has installed a respected hedge fund billionaire, Scott Bessent, as his Treasury Secretary offers some hope that he will not risk the health of the US economy or Wall Street.

> **Our assessment is that Trump's bark will likely be worse than his bite.**

Elsewhere in the world, the European Union's two major powers are both experiencing a period of political turmoil:

- France's National Assembly is in deadlock after their most recent prime minister received a no confidence vote in December, with Macron caught between far-left and far-right parties.
- Germany's centre-left, coalition government collapsed late last year. Polls suggest the conservative Christian Democratic Union-led coalition will next win power, but with the far-right Alternative for Germany party rising in popularity.

A shift in the balance of power in Europe from centrist governments to more populist parties represents a rejection of globalisation, and indicates growing dissatisfaction with a unified Europe.

Here in Australia the next Federal election may be in April. There is a strong possibility that neither Labor nor the Coalition will win enough seats to form a government without an alliance with independents and/or Greens.

[1] As has been suggested by Vice President-Elect JD Vance.

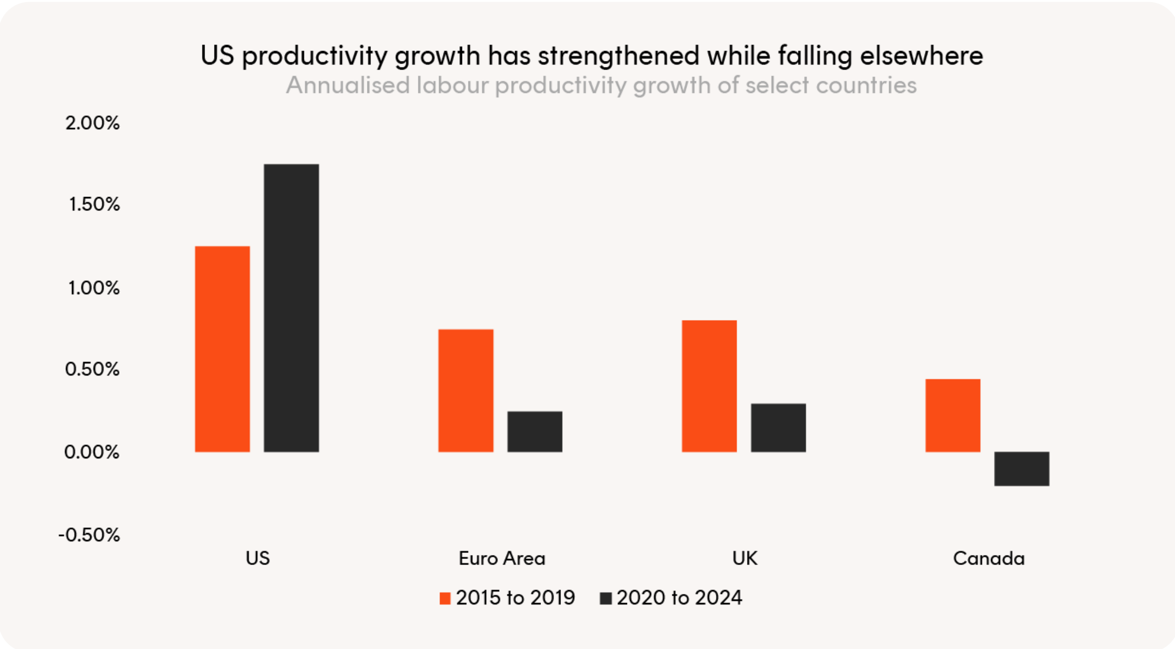
Will the US remain exceptional?

In 1900 the US represented just 14.5% of global stock markets in terms of capitalisation, today it is 74% of the MSCI World Index[2].

More recently the S&P500 has returned 20% two calendar years in a row, with seven magnificent tech stocks responsible for nearly half of those gains. What is it that has made the US so exceptional, and will its equity market continue to defy gravity in 2025?

The size and dynamism of the US economy is a good starting point in explaining the US's exceptionalism:

- Their large and flexible workforce, with wages largely determined by markets and high employee mobility across states, creating productivity growth that cannot be matched by any other major developed country;
- Individualism, risk taking and the entrepreneurial spirit are embedded in the American psyche, driving innovation and new business creation, and a venture capital ecosystem that supports new ventures;
- Low energy costs and a return to energy self-sufficiency, creating a cost advantage for industry; and
- The ability to wield hard and soft power, and the exorbitant privilege of the USD, give the US global leverage.



Source: Harver analytics, Goldman Sachs Global Investment Research.

It seems unlikely Trump's policies will disturb any of these core drivers of economic strength, with the possible exception of immigration, which may create second order impacts on inflation.

[2] UBS Global Investment Returns Yearbook, 2024

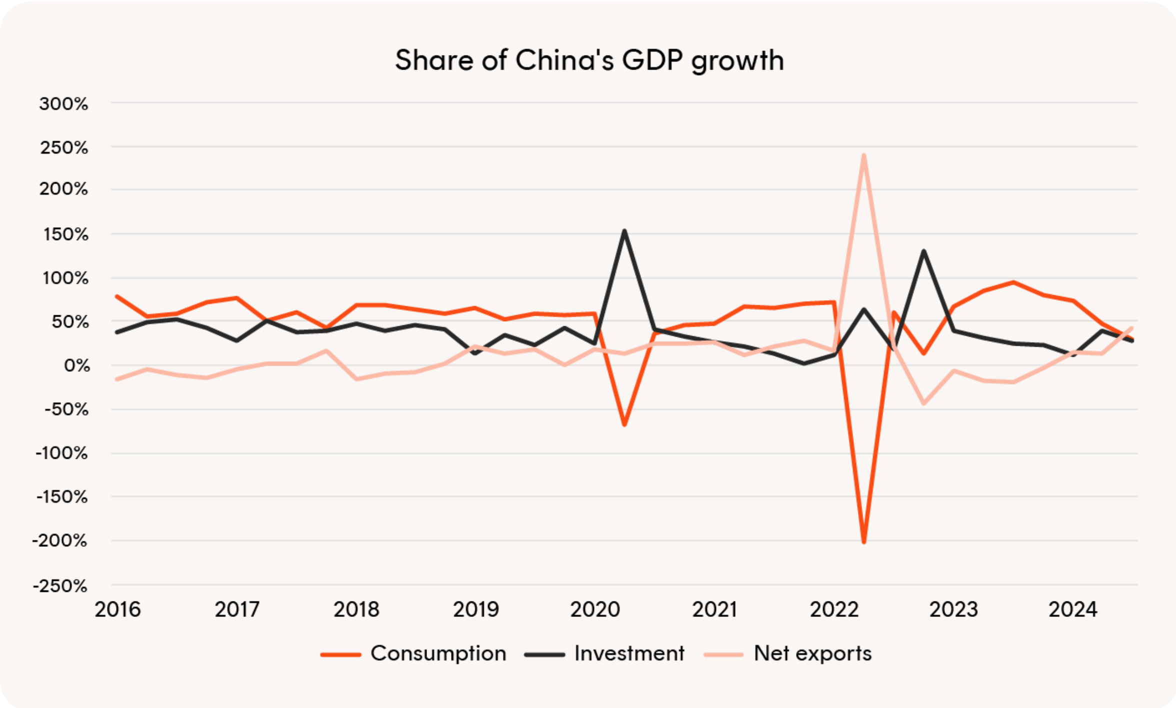
China – tentative signs, but too early to tell

China's economy enters 2025 three years into the fallout from a housing market crisis, undergoing a fundamental re-structuring after decades of investment driven growth, with a weakened consumer, and facing the prospect of a trade war with the US.

In response to this outlook the Chinese government has announced its largest fiscal and monetary stimulus since the beginning of the housing crisis, clearly setting its sights on buoying local governments, turning around consumer sentiment, and ending an emerging deflationary spiral.

China's faltering consumer, bruised by and pre-occupied with falling property prices, has meant a greater reliance on net exports for GDP growth in recent years.

While this heightens the risks around US tariffs, which are a large unknown in terms of size, breadth and ultimate effect, history points to workarounds for export driven growth – like a devalued Renminbi or greater reliance on other trading partners. Any co-ordinated effort to impose significant tariffs and stop these workarounds could be catastrophic for not only China's economy but also have much broader negative effects on the global economy.



Source: National Bureau of Statistics China. Quarterly data from Q1 2016 to Q3 2024.

Given all of this, while there are positive signs for 2025, with expectations for the housing market to stabilise and a more considered approach to future economic growth, it is likely too early with too much uncertainty to be bullish on a sustained broad China rebound.

King Dollar to lose its throne in 2025?

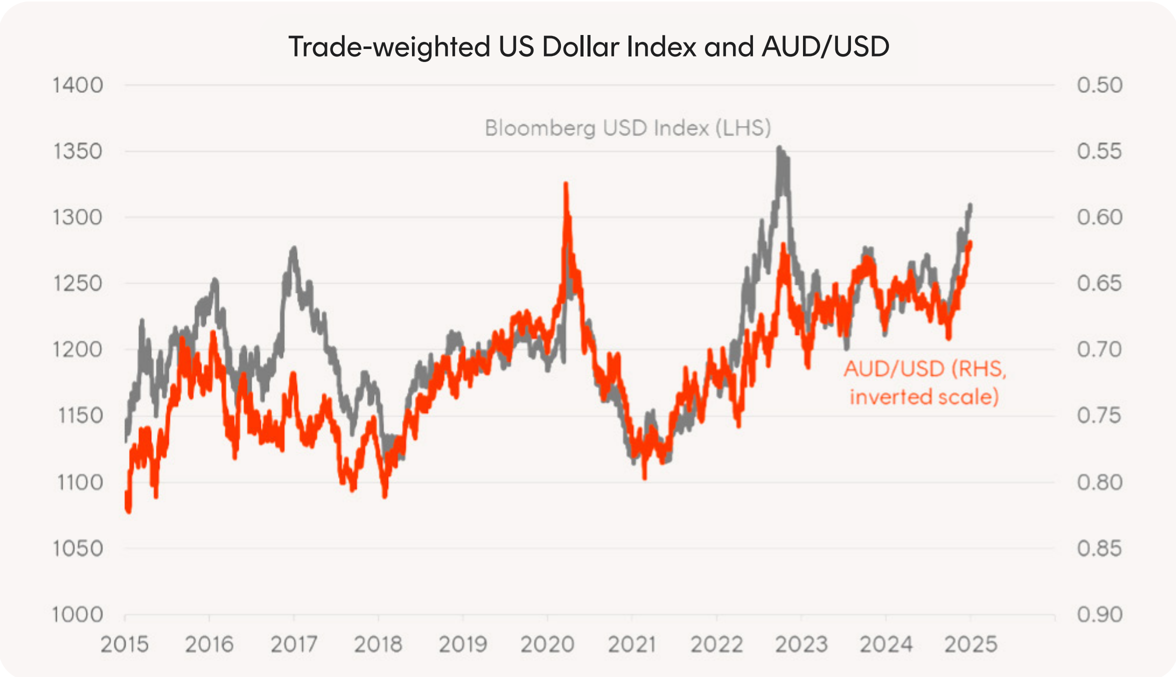
One of the strongest indicators of US exceptionalism has been evident in FX markets, where the broad US dollar index surged to its highest level on a trade weighted basis since 2022, gaining 8% in 2024.

The resilience has been surprising, given it coincided with the start of a cutting cycle from the Fed, and the index is back around levels last seen when the Fed was raising rates. Because of the broad USD strength and weakness in selected industrial commodities, the AUD/USD rate tumbled in the latter half of the year to fresh post-pandemic lows.

At the start of 2024, the USD was considered overvalued based on most fundamental currency metrics, like purchasing power parity.

The greenback's strength in the second half of the year was underpinned by the US economy's continued outperformance relative to other major economies, as well as widening nominal and real interest rate differentials against the euro, yen and Chinese renminbi.

In contrast, the economic malaise in China has reinforced the US's role as the primary engine of global growth, which weighed on commodity sensitive currencies such as the Australian dollar. The rally in the US dollar has also been amplified by the US-centric nature of the bull market in technology stocks and AI-related themes, attracting significant global financial flows into the US, a reprisal of the "new vs old economy" narrative from 25 years ago.



Source: Bloomberg. As at 31 December 2024.

Economic outlook and key themes

Looking ahead, the trade policies of the Trump administration will add a layer of complexity to the US dollar outlook. Objectives such as reducing the trade deficit and promoting onshoring may conflict with sustained dollar strength. The expectation of new tariffs on key US trading partners has already added further strength to the dollar, especially against the Canadian dollar and Mexican peso.

However, persistent dollar appreciation could weigh on corporate earnings from US multinationals, as many derive a significant portion of their revenues from abroad. As a result, a departure from the long standing "strong dollar" policy by the US Treasury may not come as a surprise. Fundamentally, the USD remains overvalued, and a softening of the US economy, the re-emergence of rate cut expectations, or a shift in government policy could catalyse a dramatic mean reversion.

Historical parallels can provide further insight. During Trump's first term, the dollar initially rallied into the inauguration, only to reverse sharply during 2017. Additionally, we can't ignore the historical precedent set by the Plaza Accord of 1985, where global leaders convened to engineer a weaker USD and stronger Japanese yen. Incidentally, this meeting took place at the Plaza Hotel in New York, which Donald Trump would famously purchase three years later.

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A significant reversal in the USD would carry profound investment implications, particularly for global equities, where around 75% of the developed market benchmark is comprised of US stocks. With the AUD/USD languishing around cycle lows, investors are naturally revisiting the question of FX hedging. While the AUD has its own unique drivers – and the RBA is likely to join the global easing cycle in 2025 – broader USD dynamics will remain the primary driver. As a result, considering FX hedging and raising FX hedging ratios may be a prudent move. With the combination of potential policy shifts from the new administration, a fundamental overvaluation of the USD and a Fed that is likely to maintain an easing bias, "King Dollar's" reign may not be as unassailable as it currently appears.

Global Equities

AI's 'show me the money' moment

The number one theme in equity markets outside of the US election has been the AI narrative.

AI advancements will continue to be a focal point in 2025, but for investors the focus is increasingly turning to how and when the Magnificent 7 will be able to generate a return on their AI capital spending.

AI adoption by corporates looks strong, with nearly all Chief Information Officers surveyed planning to adopt AI applications in the near future and acknowledging that more than 80% of existing AI applications have met or exceeded expectations[3]. The question now is how much these corporates will be willing to pay the hyperscalers for access to AI applications on an ongoing basis.

> **For investors the focus is increasingly turning to how and when the Magnificent 7 will be able to generate a return on their AI capital spending.**

Microsoft alone expects to spend US$80 billion in 2025 constructing data centers that can handle AI workloads. This is great for Nvidia, who is enjoying gross margins of 76%[4] and "incredible" demand for its new Blackwell AI chips, but ultimately AI needs end users that are going to adopt and pay for AI applications to justify the impressive growth rates expected from the Magnificent 7. In short, the fortunes of last year's AI winners depend on an AI productivity dividend flowing to the non-Tech companies within the economy.

To be clear, a large part of the valuation premium of the Magnificent 7 can be justified by the superior profitability and cash flow generation these companies enjoy, and their earnings will continue to grow at above market rates. It would be dangerous to bet against companies that have a proven long term track record of strong ROI on large scale R&D spending.

We don't expect massive underperformance from US Tech in 2025, but we believe the market's appetite for further multiple expansion is limited, so stock price returns will be more beholden to earnings growth. One caveat to this view is the possibility of groundbreaking innovation, be it in LLMs or another field like quantum computing (such as Google's breakthrough with a more efficient Quantum computing chip in December 2024).

[3] AlphaWise, Morgan Stanley Research, 2024
[4] Source: Nvidia company filings

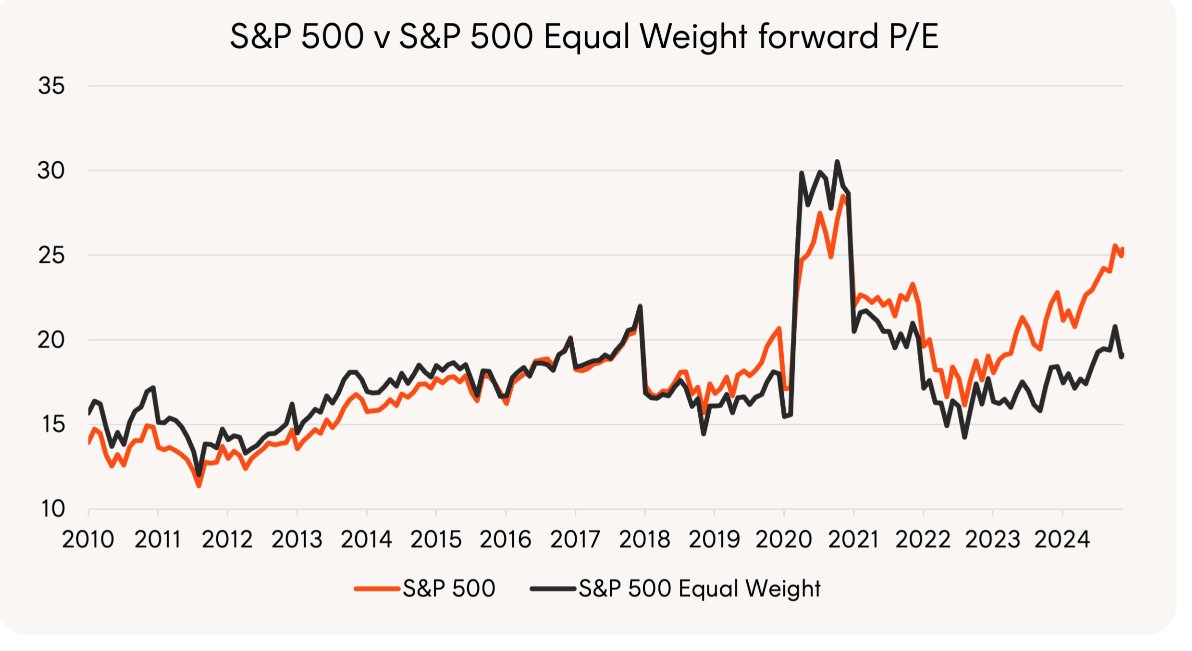
A broadening out and Trump tailwinds

The decisiveness of Trump's victory provides him with a clear mandate for change that has caused a recalibration in equity markets. As discussed in an earlier section, the new administration introduces greater policy uncertainty. Nevertheless, Trump 2.0 is thought to be good for US growth thanks to tax cuts and deregulation, as well as a potential wrecking ball for countries whom the US has large trade deficits against.

The commonly held view is that "America First" will provide a significant tailwind to US company earnings but, after years of outperformance, US equities look "expensive". We agree with the first part of that statement, but not necessarily the second.

On nearly every fundamental metric you look at, the S&P 500 index looks expensive, but the S&P 500 index is a market capitalisation weighted index, with an incredible 34% allocation to the Magnificent 7, that distorts the picture.

The S&P 500 Equal Weight index is arguably a broader representation of the US equity market. As each stock is equally weighted in this index the Magnificent 7 allocation makes up only ~1.4%. From a valuation perspective, the S&P 500 Equal Weight index is around it's long run average, and now 25% cheaper than its market cap weighted cousin.

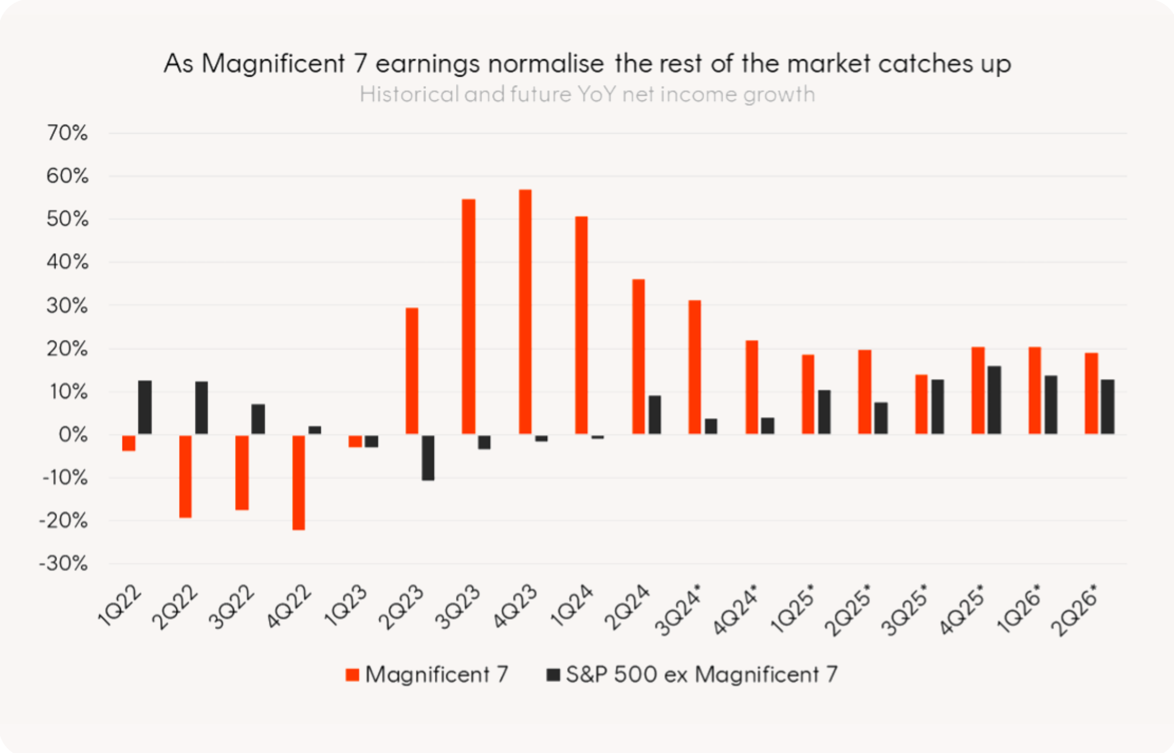


Source: Bloomberg. February 2010 to January 2025. You cannot invest directly in an index. Past performance is not an indicator of future performance.

Every sector in the S&P 500 is expected to deliver positive earnings growth for 2025[5]. This hasn't happened since 2018[6]. The rest of the S&P 500 is catching up to the Magnificent 7, and with strong forecast earnings momentum for 2025, arguably at a cheaper price[7], the S&P 500 Equal Weight index has the potential to perform well in 2025.

Every sector in the S&P 500 is expected to deliver positive earnings growth for 2025.

[5] Bloomberg consensus. 23 January 2025.
[6] JP Morgan, Building on Strength Outlook, November 2024.
[7] Source: Bloomberg. Based on analyst consensus forecasts. Compared to the market cap weighted S&P 500 index and based on current valuations. Actual results may differ materially from forecasts.
[7] Calculated using S&P 500 price to earnings ratio and US 10-year government bond yields. As at Actual results may differ materially from forecasts. Compared to the market cap weighted S&P 500 index and based on current valuations



Source: Bloomberg intelligence. As at 11 January 2024. Magnificent 7 includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA and TSLA. Figures for 4Q 2024 onwards are analyst consensus forecasts. Actual results may differ materially from forecasts.

Still a lot could go wrong. The equity risk premium on the S&P500 market cap weighted index is currently negative[8]. Tariffs and deporting immigrants could (1) reintroduce inflation into the equation, driving bond yields higher and inducing a valuation-based sell-off, or (2) stifle US growth hurting corporate earnings. Markets may have also got ahead of themselves on the prospect of tax cut tailwinds. In any case, volatility will be elevated by the manner in which Trump conducts negotiations and makes policy announcements on the run.

These are good reasons to consider US equities that are not necessarily priced for perfection and high-quality global equities to weather the coming storm. Defensive asset classes are also likely to provide a greater diversification benefit in 2025 in our view.

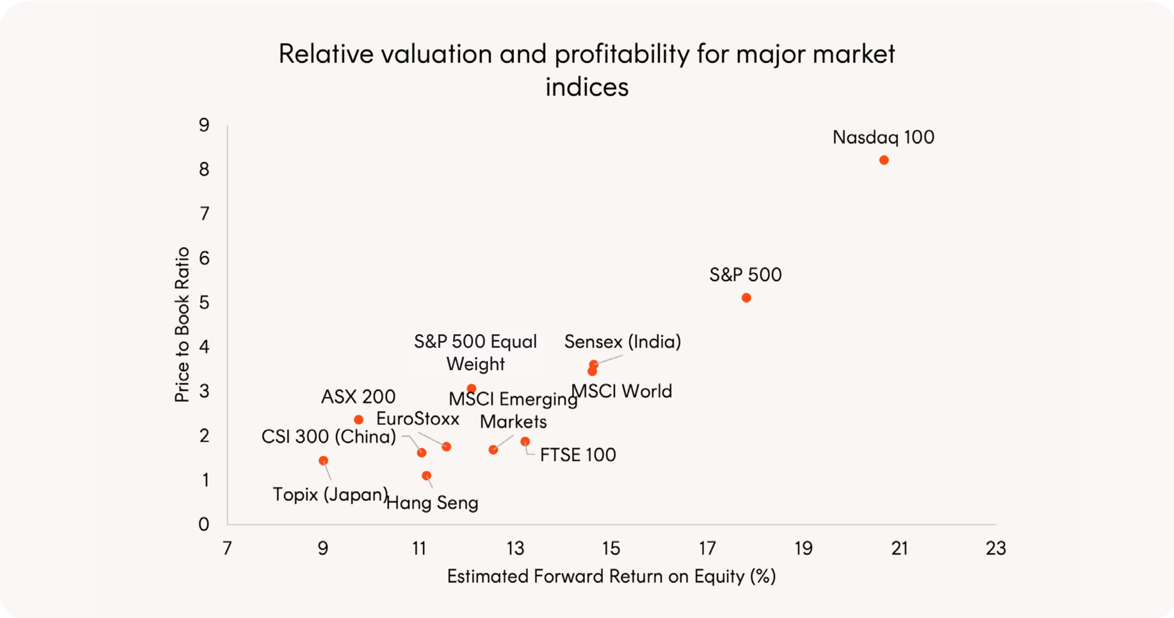
The best of the rest?

In Europe, expectations for corporate earnings are far more subdued as the continent contends with stunted economic growth at home and China, an important trading partner for its luxury-goods and car companies. European companies must now also contend with domestic political uncertainty with US protectionism and corporate investment being redirected from the Eurozone to the US.

Within Europe, the UK may act as a hedge against the Middle East crisis, due to the large Energy sector weight within the FTSE 100. The UK market is also defensive, offers high dividends, and is more resilient to rising energy prices compared to the Eurozone. Critically the UK's trade with the US is mostly services rather than goods, and is one of the few large trading partners that the US enjoys a trade surplus with – putting the UK at less risk of draconian US tariffs.

[8]Calculated using S&P 500 price to earnings ratio and US 10-year government bond yields. As at 23 January 2025.

Global Equities



Source: Bloomberg. As at 31 December 2024. You cannot invest directly in an index. Past performance is not an indicator of future performance.

Japanese equities appear good value relative to the US, although rising inflation complicates the situation by prompting the Bank of Japan to raise rates, which then strengthens the yen and impacts earnings. Nonetheless, the end of deflation and reforms in corporate governance are positive signs. A key risk is any efforts made to weaken the USD against the yen.

Tactically Chinese equities may present opportunities, like in the technology sector if the government looks to the industry for future economic growth supported by subsidies. However, as a whole, there remains safer investment opportunities elsewhere globally – particularly on a risk adjusted basis with heightened volatility expected as they continue to deal with the fallout of a housing market crisis and a structural change to economic growth.

Investors still looking to fill the hole left in emerging market allocations by China's struggles could look to India. The long-term structural case for India remains very strong with the three pillars of favourable demographics, progressive government policy and geopolitical alignment driving a consumption boom, record capital flows and ultimately strong company fundamentals.

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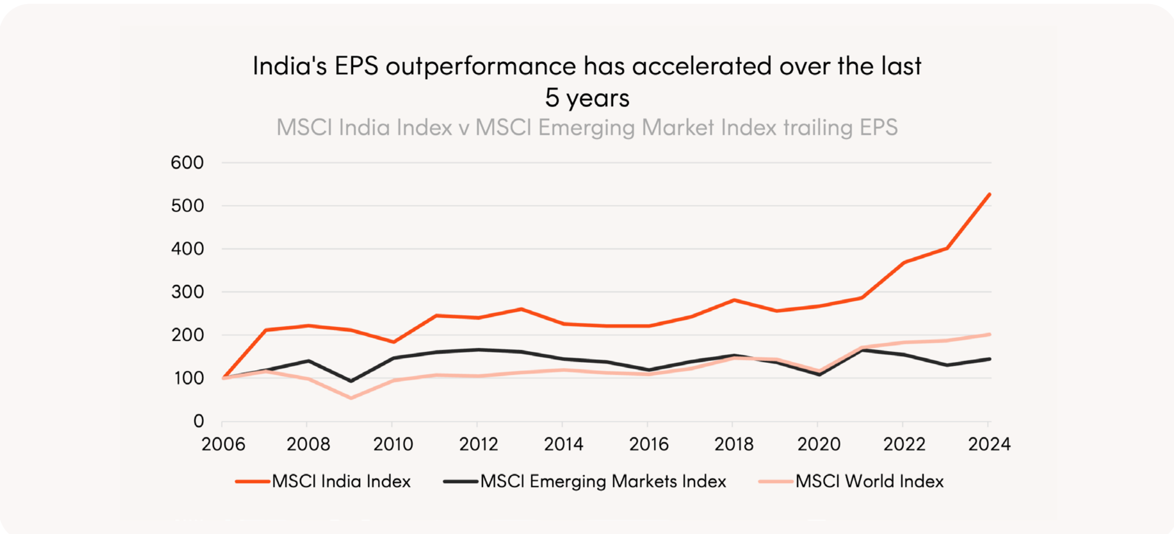


Source: Bloomberg. 29 December 2006 to 31 December 2024. Indexed to 100 as at 29 December 2006. IIND seeks to track the Solactive India Quality Select Index NTR. You cannot invest directly in an index. Past performance is not an indicator of future performance. Provided for illustrative purposes only.

Investment ideas

A broadening out of US equity market performance

The **Betashares S&P 500 Equal Weight ETF (ASX: QUS)** offers a cost-effective exposure to 500 leading US companies using an equal weight approach. The S&P 500 Equal Weight index arguably presents a cheaper entry point for US equities and is forecast to see strong earnings momentum in 2025[9].

It's also an exposure which is arguably more favoured by Trump's proposed policy changes:

- Particularly for the largest two sector weights; US Financials are likely to enjoy increased profitability due to deregulation and Industrials stand to benefit from possible tariffs on overseas competitors and support for US manufacturing.
- The proportion of total revenues sourced from the US is about 70% for the Equal Weight index, much higher than the market cap weighted S&P 500. Large offshore earners like Apple are most exposed to a stronger USD eroding earnings or potential blow back from Trump's possible tariffs. Goldman Sachs research recently highlighted the negative correlation between broad dollar strength and S&P 500 earnings surprise.
- On the other hand, domestically oriented companies, which have a greater representation in the Equal Weight index, also generally tend to pay more tax,[10] making them bigger beneficiaries of Trump's proposed corporate tax cuts.

Australian investors seeking a currency hedged exposure can consider **Betashares S&P 500 Equal Weight Currency Hedged ETF (ASX: HQUS).**

Quality without concentration

Taking a broader lens to global equities points to investors benefitting from staying up the quality curve. High quality companies are characterised by their sustained high earnings, which are central to 2025's outlook as earnings will be under scrutiny for US tech giants and European and Australian laggards alike. And low leverage, making them less sensitive to negative interest rate surprises that could emerge throughout the year. If we see the anticipated broadening out of equity market returns within or beyond the US it is likely that large cap, higher quality companies will be the beneficiaries as markets remain in the late phase of this cycle.

Betashares Global Quality Leaders ETF (ASX: QLTY) provides investors with access to a diversified portfolio of 150 of the world's highest quality companies. Crucially QLTY maintains a 2% stock cap on rebalances to avoid the concentration risk currently present in other indices.

Emerging giant

We see India's recent economic slowdown as temporary and expect it to be corrected through the course of 2025. Government spending is expected to pick back up after a typical election year slowdown and already healthy domestic demand from consumers and the private sector should receive a further boost as inflations continues to normalise. The recent selloff could be a compelling opportunity for investors to add to long-term strategic positions in the region.

Within India taking a quality investment approach can resolve common shortcomings of investing in the region, like avoiding top-heavy Indian broad market index exposures concentrated in large banks, avoiding speculative or unprofitable companies with high levels of risk, and failing to capture companies with strong fundamental growth prospects.

Investors can gain exposure to a portfolio of high quality Indian companies through **Betashares India Quality ETF (ASX: IIND).**

[9]Source: Bloomberg. Based on analyst consensus forecasts. Compared to the market cap weighted S&P 500 index and based on current valuations. Actual results may differ materially from forecasts.
[10]Source: OECD, Base Erosions and Profit Shifting, OECD Policy Issues website.

Australian Equities

Should CBA be more expensive than Alphabet?

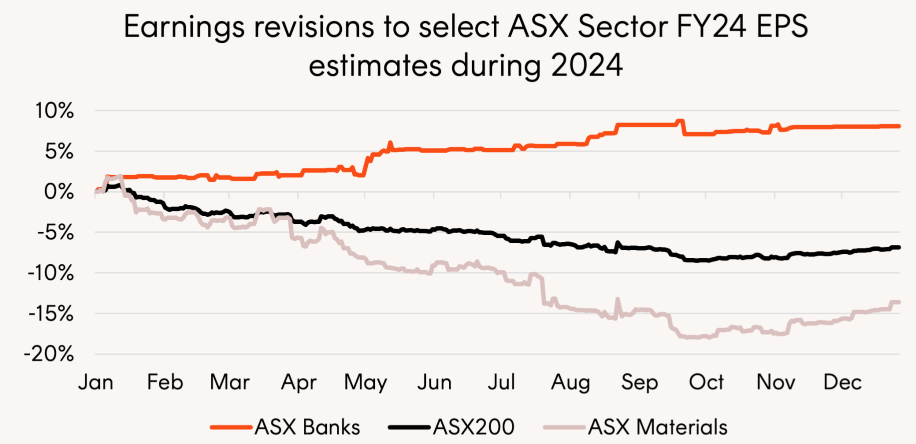
In Australia, the outperformance of our banks in 2024 has left many investors mystified. They look expensive – on a price to book basis, CBA is the most expensive large cap developed market bank in the world, and Macquarie is second.

CBA has not had an analyst buy rating on it for nearly three years. How did our banks go on such a run?

The answer is upward revisions in their earnings throughout the year. Unlike nearly every other sector on the ASX, and the index as a whole, the banking sector saw strong upgrades in their expected earnings throughout 2024.

With earnings from the Materials sector falling, banks became the TINA (there is no alternative) trade of Australian equities. Some Australian active managers have specifically avoided or underweighted the banks, but our $2.6 trillion superannuation industry has been stepping in directly as a net buyer.[11]

While positive earnings revisions and a willing buyer can explain the strong price performance in 2024, the rally in bank shares started coming from a shaky foundation given their valuations were already expensive and their expected earnings growth has only improved from negative to flat.



Source: Bloomberg. As at 8 January 2025. Reflects changes in consensus Bloomberg earnings estimates for FY24 EPS from January 2024 to December 2024 for select ASX sectors.

[11] AFR, "Super the key to untangling CBA share price puzzle: JPMorgan", 7 January 202

The big five banks (including Macquarie) now represent 26% of the S&P/ASX200 by weight, but this concentration is not at extremes and in fact sits around its average. Of greater concern is that valuations appear stretched, given the low earnings growth outlook at an index level.

The S&P/ASX 200's strong run has been driven by investors willing to pay more for company earnings, rather than actual earnings growth.

Earnings per share for the S&P/ASX200 index fell in the last two financial years, and the broad-based downgrades throughout 2024 are not an encouraging sign for 2025.

There are reasons to be positive though

The silver lining to a weakening AUD is higher earnings for offshore earners (particularly across Materials, Healthcare and IT), and the relative attractiveness of Australian companies as M&A targets. Somewhat related, Iron ore and oil prices have had a reasonably strong start to the year.

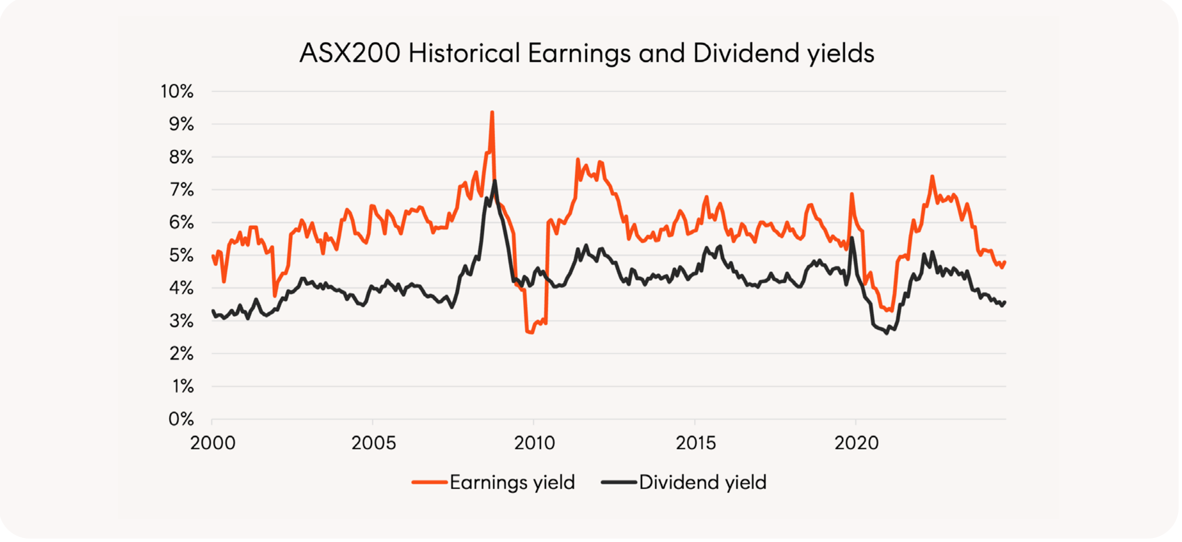
Retail sales figures have picked up following last year's tax cuts and Black Friday sales were strong, albeit with significant discounting activity. And government spending commitments may increase given the upcoming election. In addition, easing the RBA cash rate over 2025 should lead to a gradual acceleration in residential investment following a three-year slump in activity.

Australia's disappearing dividends

The Australian equity market has long provided consistently strong dividend income. However the source of that dividend income has become increasingly concentrated into three sectors over time – Financials, Materials and Energy.

Where earnings go, dividends will follow.

Falling commodity prices have led to cuts in dividends from Materials and Energy over the last couple of years from the miners and Woodside. On the other hand, bank dividends have not been cut, but their growth has failed to keep up with stock price appreciation. This double whammy has left the S&P/ASX 200 Index dividend yield languishing at 3.5% pa.



Source: Bloomberg. May 200 to December 2024. As at 31 December 2024.

Combined with the eventual wind up of listed bank hybrid securities, structurally lower dividend yields mean many income-focused investors and retirees will be looking to solve for their income needs through other means.

Investment ideas

Australian quality – earning the title

Although concerns persist about the earnings outlook for Australia's large-cap companies and the broader index, growth opportunities remain in pockets of the ASX for investors.

Financials and Materials are two inherently cyclical sectors, which historically have tended to find themselves at opposite ends of their respective cycles (fortunately for investors). However, with the prospect of synchronised underwhelming returns from both banks and miners, investors should consider how they can reduce cyclicality in their portfolios.

To that end, investing in a diversified exposure to high quality Australian large and mid-cap companies that have strong profitability, more consistent earnings and lower financial leverage may be additive to portfolios.

Last financial year, the index which **Betashares Australian Quality ETF (ASX: AQLT)** aims to track experienced earnings growth of 20% compared to a fall of 4.6% for the S&P/ASX200. AQLT returned 23% last year, more than doubling the return of the broader S&P/ASX200 index.[12]

AQLT provides investors with access to 40 of Australia's highest quality companies.

Making up for falling dividends

For many years Australian equities had provided consistently strong and growing dividend income. That has now changed. For investors seeking to make up for lost equity income, **Betashares Australian Top 20 Equity Yield Maximiser Fund (managed fund) (ASX: YMAX)** had a distribution yield of 7.0% last year, or 8.4% grossed up for franking credits, versus the S&P/ASX200 gross yield of only 4.5% (3.5% net).[13]

YMAX uses a "covered call" strategy to generate additional option premium income on top of dividends received. Such a strategy is best suited to neutral (or sideways trading) markets to gradually rising markets, as it does provide some upside participation to capital growth and growing dividends. However, it would usually be expected to underperform an equivalent portfolio without a covered call strategy during a strongly rising market.

[12] Past performance is not indicative of future performance.
[13] Yield is calculated by summing the prior 12-month per unit distributions divided by the closing NAV per unit at the end of the relevant period. Yield will vary and may be lower at time of investment. Past performance is not indicative of future performance.

Fixed Income

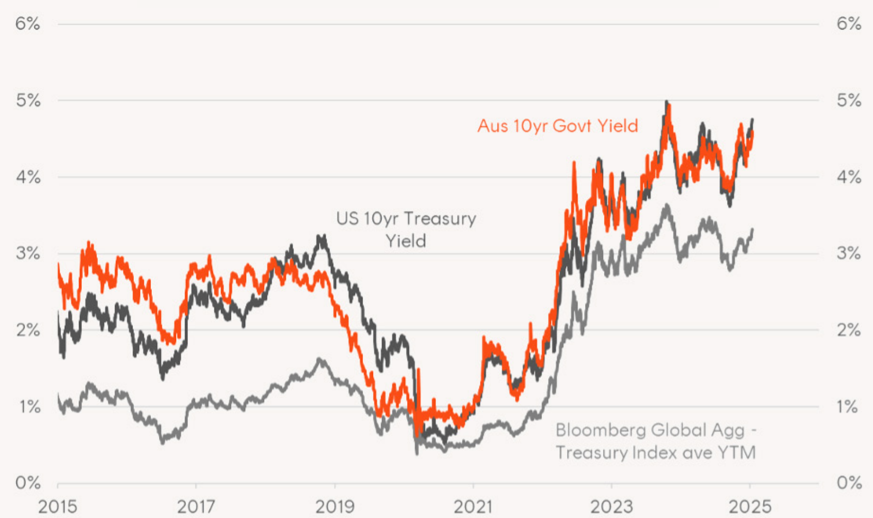
Yields rise despite cuts, term premium returns

As we enter 2025, the surge in bond yields has become a defining feature of global markets. Since mid-September, the 10-year US Treasury yield has risen by 100 basis points – a remarkable move, given that the Federal Reserve cut rates by the same magnitude during this period.

Historically, this is a highly unusual development and highlights the growing influence of fiscal concerns, coinciding with the most common measures of term premia reaching their highest levels in years. Additionally, lingering doubts about the ability of traditional fixed income to effectively hedge equity risk in portfolios may also be a contributing factor, with stock-bond correlations fluctuating between positive and negative territory depending on the macroeconomic narrative.

It is worth noting that traditional fixed income, more than other asset classes, structurally embeds mean reversion in returns. Higher yields may lead to drawdowns in the short term, but they also improve forward-looking return expectations. A bear steepening trend and higher term premia raise the expected excess returns compared to cash and short-duration equivalents.

Benchmark Government Yields

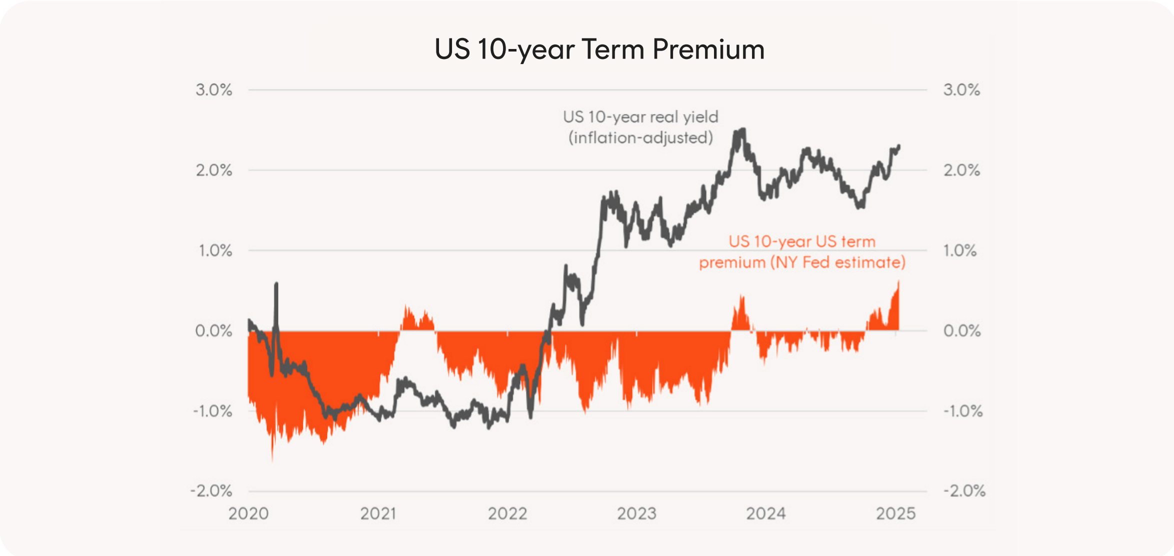


Source: Bloomberg. As at 31 December 2024. Past performance is not indicative of future performance.

In addition, real yields above 2% – as seen in both Australian and US 10-year government bonds – effectively guarantee positive real returns on inflation-linked bonds and imply a high likelihood of nominal bonds beating inflation over the typical strategic asset allocation horizon.

While the current macro environment and deficit concerns tied to the incoming US administration may challenge long-duration bonds in the near term and keep yields under pressure, they are still a crucial part of multi-asset portfolios for medium- to long-term investors.

With global equity markets coming off consecutive strong years and valuations still appearing stretched, the case for adding duration as portfolio insurance has strengthened. Oversold conditions and enhanced relative value suggest that long-term government bonds are poised to rally in response to any negative surprises in US or global growth. Furthermore, the improved value of duration now offers investors a rare opportunity to be rewarded for holding traditional safe havens.

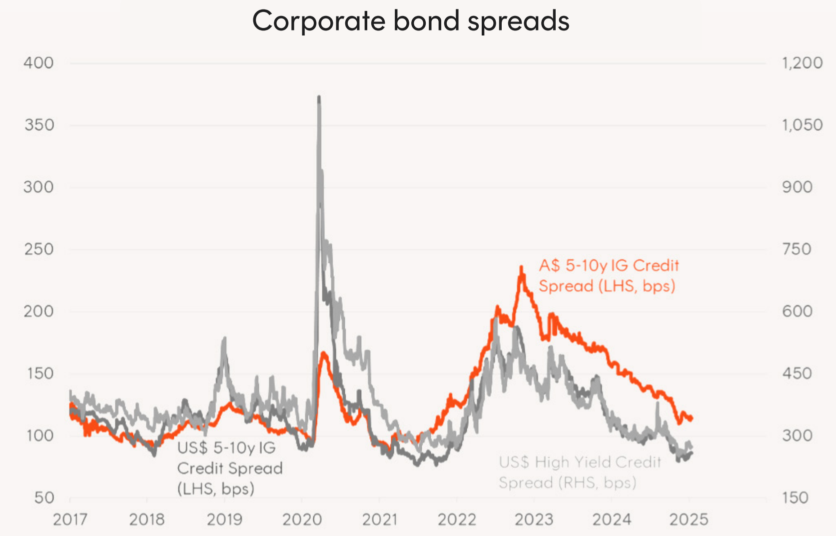


Source: Bloomberg. As at 31 December 2024. Past performance is not indicative of future performance.

Relative value in AUD Credit

Global credit markets showed remarkable resilience during 2024, withstanding volatile benchmark yields and growing policy uncertainty, the August "carry trade unwind" deleveraging event, and even the re-emergence of Eurozone sovereign risk. Ultimately, with interest rates at or around the highest levels in years, outright yields on credit remains compelling, even if spreads in some markets are around the tightest levels for this cycle tights. The further paring back of US recession risks amid the pro-growth policies of the incoming Trump administration will likely support risk-on expressions within fixed income, although questions remain about the risk/return asymmetry, especially in the most cyclical exposures like US high yield and private credit as we face the realities of greater economic and geopolitical volatility.

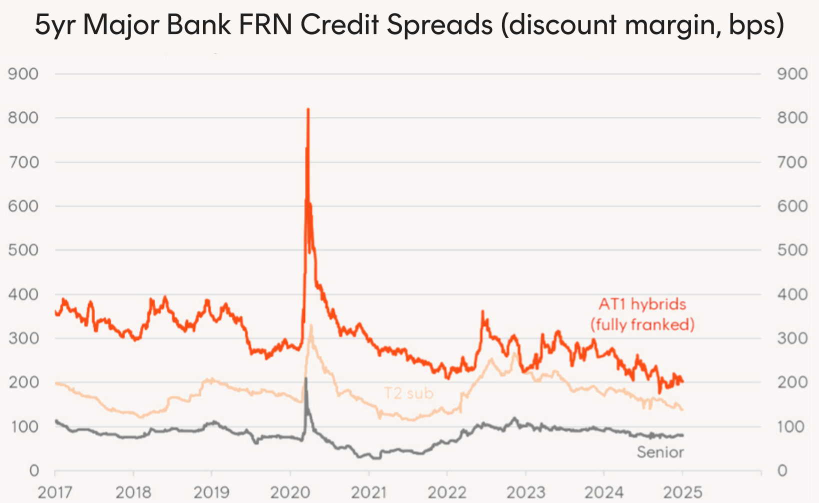
Australian dollar credit continues to provide relative value, both on an outright yield basis against FX-hedged global alternatives and in terms of credit spreads on a like-for-like basis. AUD corporate bonds had a strong 2024, helped by the prevailing soft-landing narrative, with the spread compression more than offsetting any duration headwinds that emerged late in the year. With 2025 providing us with higher benchmark yields and steeper curves, fixed rate corporate credit still has a lot going for it and may be the sweet spot as we move closer to the RBA commencing rate cuts against a backdrop of ever-receding US recession risk.



Source: Bloomberg. As at 31 December 2024. Past performance is not indicative of future performance.

Financials were also in focus during 2024, with APRA formalising the phasing out of the bank hybrid (AT1) market. Although a contentious policy from the perspective of market participants and investors, this development is unlikely to dent the broader attractiveness of domestic bank credit, especially at a time when domestic bank shares appear richly valued (and delivering inferior yields to even the senior bank debt).

However, credit spreads across both Tier 2 and hybrids are much tighter than they were a year earlier, and potentially better value can be found in high grade segments of the domestic "spread product" universe, including the state governments and AAA-rated supranationals.



Source: Bloomberg, Westpac. As at 31 December 2024. Past performance is not indicative of future performance.

Investment ideas

Getting paid for portfolio insurance with government bonds

The fact that 10-year US Treasury yields have risen for four consecutive calendar years (with Australian 10-year yields largely moving in lockstep) should not be seen as negative for bond investors. On the contrary, this trend arguably makes long-duration government bonds less risky now due to higher expected returns.

Oversold conditions and enhanced relative value suggest that long-term government bonds are poised to rally in response to any negative surprises in US or global growth. Furthermore, the improved value of duration now offers investors a rare opportunity to be rewarded for holding traditional safe havens.

For investors seeking the purest exposure to the US 10-year Treasury, consider **Betashares U.S. Treasury Bond 7-10 Year Currency Hedged ETF (ASX: US10).** Investors in Australian fixed income can achieve targeted exposure to 10-year Commonwealth yields through **Betashares Australian Government Bond ETF (ASX: AGVT),** which comprises 7–12-year Commonwealth, state and government-related bonds.

A better, simple fixed income core

Betashares Australian Composite Bond ETF (ASX: OZBD) aims to track an index that was designed to address shortcomings in traditional index approaches. OZBD has the potential to deliver superior returns to both active and simple market cap-weighted passive approaches.

OZBD's index has outperformed the AusBond Composite 0+year Index 10 out of 13 years since common inception, including last year, when it delivered a respectable 3.83%p.a. despite rising government bond yields.

Cash ain't trash

In an era of growing policy and economic uncertainty, complete with both left and right-tail risks (i.e. growth and inflation respectively), cash can provide optionality and tactical flexibility not found elsewhere and, if cash rates remain around 3-4%, can also remain a viable, stable source of income.

Betashares Australian Cash Plus Fund (managed fund) (ASX: MMKT) is able to provide an enhanced yield by investing in AUD dollar cash and high-quality, short-term money market securities with remaining maturities of less than one year issued by investment grade rated entities, using a buy-and-hold approach. Over the cycle, we have seen that money market securities can offer a material yield uplift over bank deposits. In 2024 MMKT returned 4.87% net of fees for investors.

Beyond the Core

Structural growth opportunities and hedging tail events

While core allocations serve as the bulk of investor portfolios, the value add from satellite positions – often smaller tactical positions in areas with structural growth opportunities – should not be overlooked.

Satellites positions can be used by investors to leverage opportunities for outperformance over broader market exposures, access tactical and long-term structural growth themes or sectors, provide diversification benefits to portfolios, and hedge against possible tail risk events.

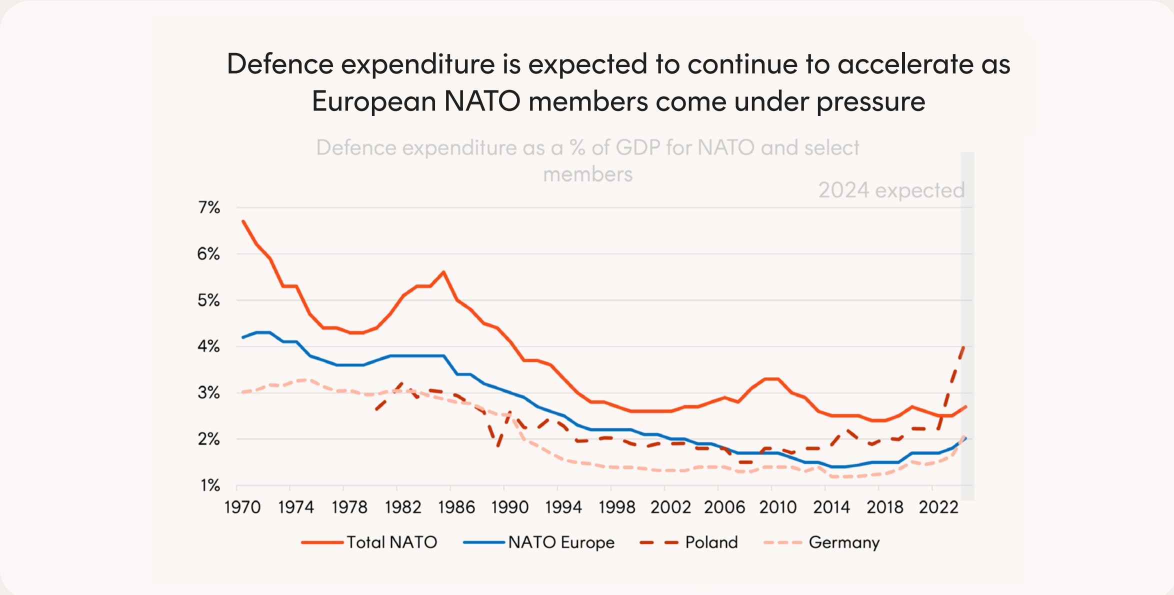
We highlight four areas we believe can add value as satellite positions in investor portfolios for 2025 and beyond.

Investment ideas

Deglobalisation and defence

Defence spending has been accelerating globally since Russia's occupation of Crimea in 2014 – the full-scale invasion of Ukraine only furthered this trend. 2024 is expected to be the 10th consecutive year that defence spending increased, reaching a new record of over $US2.5t. The trend towards deglobalisation is spurring a wave of self-sufficiency across essential industries, and chief amongst those industries is defence.

Beyond increasing global tension and conflict, Trump's second term will keep defence spending in the spotlight. Trump, as he did in his first term, has begun to put pressure on NATO countries to start meeting and increasing their annual target for defence spending, from 2% p.a. to 5% of GDP p.a. – NATO members will hold talks in June about the current target and increasing it. Last year, a record 23 of 32 NATO members are expected to have met the current target, up from just six members in 2021.



Source: NATO. 1970 to 2024. 2024 numbers are NATO estimates.

Further, Trump will likely look to broker major contracts for defence exports to balance trade with allies while promoting 'America first' through the US' world leading defence industry. Talks have already begun with Taiwan for a US$15bn deal for US military hardware. For context, during the Biden administration a total of $US7bn of deals were approved with Taiwan.

Betashares Global Defence ETF (ASX: ARMR) offers investors exposure to leading companies involved in the global defence sector. ARMR's index, the VettaFi Global Defence Leaders Index, performed strongly in 2024, returning 53% and bringing its 3-year returns to 30% p.a. With strong momentum in underlying fundamentals and record levels of order books, the largest defence companies remain well placed for future growth.

[14] Source: https://www.wsj.com/tech/cybersecurity/typhoon-china-hackers-military-weapons-97d4ef95

Navigating an evolving threat landscape

Cybersecurity remains a critical need in today's society, as advanced technologies such as AI expand the attack surface area for adversaries to act upon. As a result, organisations globally have recognised the importance of developing strong security software systems in a geopolitically fragmented world that has only intensified the threat environment.

We see evidence of this with double digit spending growth on security software, which is expected to exceed US$260b[14] in 2025. This backdrop will likely support earnings for established cybersecurity companies with leading-edge product offerings such as CrowdStrike and Palo Alto which are both key holdings in **Betashares Global Cybersecurity ETF (ASX: HACK).**

Geopolitical tensions between the US and China have also extended beyond tariffs and trade policies, and into protecting national security concerns. Advanced threat actors such as 'Salt Typhoon' – reportedly linked to China's Ministry of State Security – attacked dozens of US ports, power grids and telecom providers such as AT&T and Verizon over recent years. And the rapid evolution of advanced technologies like AI will likely mean that the frequency and sophistication of these attacks may continue to grow.

Finally, capital market activity has been supportive for continued deal flow into the sector. Cybersecurity M&A activity was strong in 2024 with deal volumes returning to near all-time highs with activity anticipated to continue rising in 2025 driven by an improving economy, lower interest rates and a high accumulation of dry powder.

China and India, rather than AI, to drive strong demand for Uranium

In 2024 Microsoft, Amazon and Alphabet signed nuclear power agreements to supply some of their AI data centres with the vast amounts of power they consume. These innovative companies and their wealthy founders are also investing billions to develop Small Modular Reactors (SMRs), with the promise of cutting the time and cost required for construction of a nuclear power plant.

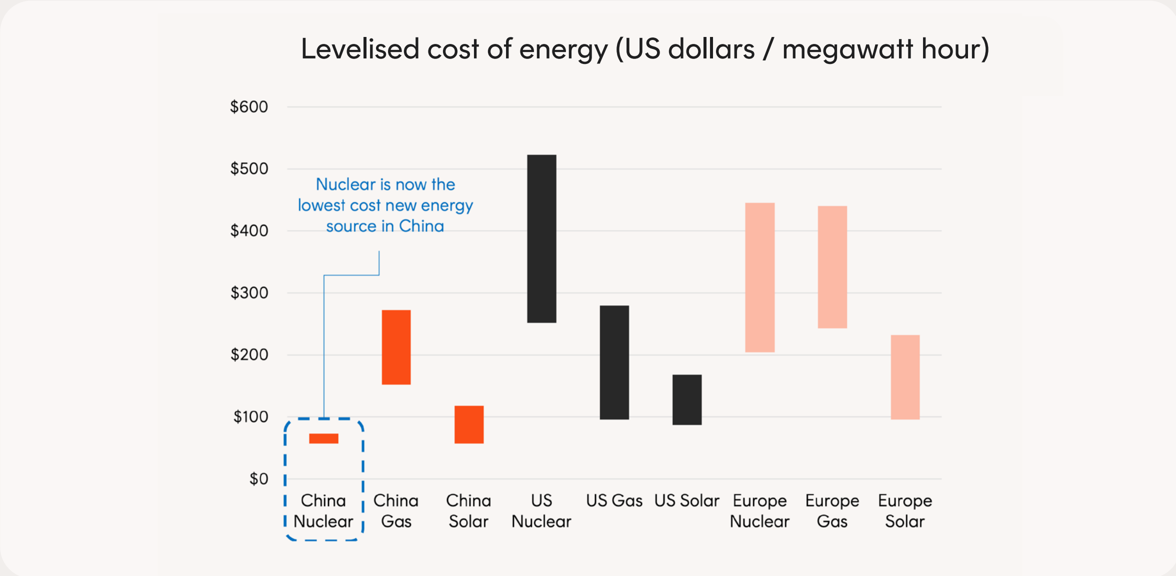
Yet, commercialisation of SMR technology could be more than 5 years away, and the expansion of nuclear capacity in the US will be slow. Demand for uranium will increasingly be driven by new nuclear power generation coming online in emerging markets, rather than what happens in the West. China has 24 reactors under construction, that will add 250 terawatt-hours (TWh) of generation capacity by 2028, followed by India with seven under construction, growing their capacity by 75% to reaching 100 TWh by 2028. These countries are able to build nuclear reactors in less time and at lower cost than developed countries, like the US and Europe. And critically their levelised cost of energy for nuclear is approaching or even undercutting fossil fuel and renewable generation.[15]

> **Demand for uranium will increasingly be driven by new nuclear power generation coming online in emerging markets, rather than what happens in the West.**

Bloomberg expect the global uranium output to increase by 24% by 2028, reaching an annual total of approximately 202 million pounds of U_3O_8 uranium concentrate.[16] The market is currently in deficit due to the long lead times required to develop uranium mines and ongoing supply chain constraints, which are supporting prices. These favourable supply-demand dynamics provide the opportunity for companies like Cameco, Paladin Energy and Boss Energy to expand production in the US, Canada, Namibia and Australia at the expense of high cost marginal producers in China and India.

Betashares Global Uranium ETF (ASX: URNM) provides access to a diversified portfolio of the leading companies in the global uranium industry, such as Cameco, Paladin Energy and Boss Energy.

[15] Source: Bloomberg Intelligence, Uranium Global Industry Outlook 2024, 26 June 2024
[16] Source: Bloomberg Intelligence, Uranium Global Industry Outlook 2024, 26 June 2024



Source: BloombergNEF. As at June 2024. Bars represent low and high levelised cost of energy (US dollar / megawatt hour). Solar estimates include the cost of 4 hours of battery storage capacity.

Go for gold, structural demand and a tail risk hedge

In a period of escalating geopolitical tension, gold provides some unique characteristics to diversify risk embedded in other asset classes. As a reliable store of value, holding gold is important for central banks to diversify their reserves beyond foreign currencies like the USD and US Treasuries. In the wake of the Ukraine invasion, the US showed they were not afraid to 'weaponise' the dollar-centric global financial system by imposing crippling sanctions on another nation state. As the world's reserve currency, the USD gives the United States enormous leverage on the world stage.

In response to this threat, the central banks of countries that wish to remain non-aligned or independent of the US have become huge buyers of gold in recent years. Since 2022, total reported central bank buying has jumped significantly thanks to emerging market and Eastern European countries like China, India, Poland, Turkey and Egypt.

If the deficit widens further under the new US administration, concerns around the serviceability of US government debt may blow out Treasury yields and weaken the US dollar. Historically, there has been a strong correlation between rising US budget deficits and gold prices. Alternatively, a growth scare or pick-up in inflation is also an environment where gold can act as a defensive ballast.

As the only currency hedged gold ETF available on the ASX, **Betashares Gold Bullion ETF – Currency Hedged (ASX: QAU)** offers a truer exposure to the USD gold price.

There are risks associated with an investment in each of the Funds. Investment value can go up and down. An investment in any Fund should only be made after considering your particular circumstances, including your tolerance for risk. For more information on the risks and other features of a Fund, please see the relevant Product Disclosure Statement and Target Market Determination, available at www.betashares.com.au.

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